

15000 POST DISSOLUTION/TAX CLEARANCE

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15001 POST-DISSOLUTION /TAX CLEARANCE -IN GENERAL

Before a corporation can be dissolved, surrendered, or merged from California, it must file the proper documents with the Office of the Secretary of State and with the Franchise Tax Board to receive a Tax Clearance Certificate. For more information refer to FTB Publication 1038, Instructions for Corporations Requesting a Tax Clearance Certificate. * * * * *

In accordance with the law, FTB has 30 days after receipt of the request in which to notify the person requesting the certificate that further action is necessary. A corporation may request a tax clearance certificate based on the following:

- Assumption of Liability: an individual or another corporation agrees to assume any future tax liabilities of the entity that is ceasing its existence.
- Final Return/Taxes Paid Basis: the returns are audited immediately and the tax clearance certificate is issued only after all audit issues are resolved and/or balances due are paid.
- Surety Bond or Cash Deposit: the corporation will post a bond or make a cash deposit. FTB will release the bond or refund the cash deposit after the Post Dissolution Audit Team determines that there is no tax liability. The audit is generally completed within one year after the formal dissolution. The minimum amount of a bond or deposit is \$2,000.

For those corporations requesting a tax clearance certificate under any of the methods other than the Taxes Paid Basis, the account is reviewed at the time of the request. If the corporation is current with filing their tax returns and does not have a liability, a tax clearance certificate will be issued immediately. * * * * *

* * * * * If the result of the post dissolution audit is an assessment, the assumer is responsible for the additional liability. If a surety bond or cash deposit were posted, these are kept to cover the additional balance.

Sometimes a corporation will request a tax clearance certificate but will not be current (i.e., not all returns have been filed and/or the corporation has an outstanding balance). The law requires FTB to notify the requestor within 30 days that a further action is necessary. A tax clearance certificate will not be issued until the account is current. This also applies to corporations, which file an assumption of liability when requesting a tax clearance certificate. The assumer is responsible for any balances occurring subsequent to the date of dissolution, while the corporation is responsible for any liabilities occurring before the date of dissolution. Once the account is current, a tax clearance certificate will be issued. * * * * *

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Requesting a Tax Clearance under Taxes Paid Basis

MSA Central Office receives tax clearance boxes, in which the corporation has requested a tax clearance based on a taxes paid basis. These requests are forwarded to MSA Central Office to be scoped for possible audit issues and should be returned to the Tax Clearance unit within a week or two of assignment. Items to take into consideration are:

1. Check the box to make sure all corporation folders listed on the cover sheet are in the box. If a folder is missing or additional folders are in the box, make a note of this on the cover sheet.

2. Review Folder to make sure that all corporation tax returns are available for scoping (Check BETS and PASS). The Tax clearance unit should only refer corporations where all the returns are in the folder. If not,
 - Review the tax clearance correspondence for the date the business ceased or will cease to do business in California. This will be the last tax return to be filed.
 - Check to see if a copy of the return is attached to the tax clearance correspondence. If so, verify net income and tax against BETS.
 - Check with Data Services & Storage or PASS to locate any missing returns.

3. Organize the contents of the file. Put returns in tax year order to determine if any years are missing. The Tax Clearance correspondence and loose paperwork should be arranged in chronological order and stapled together with the Tax Clearance correspondence on top. The Tax Clearance package should be placed in front of the folder.

4. Scope all OPEN year corporation tax returns for audit issues. *****

5. Scope the final tax year:
 - Review balance sheet – look for ending balances, assets & liabilities
If so, request a complete list of assets and liabilities distributed in liquidation to determine disposition of assets that are likely to appreciate

 - Review Accounts Receivable – A cash basis t/p must report all ending A/R in income in the year of dissolution. Therefore, if a corporation had A/R from services completed prior to liquidation, it should be included in income on the corporation's final return. *****

 - Review final return for deferred income – If there is no reorganization, the deferred installment sales must be included in income for the corporation's final year.

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- Gain on distribution of assets – IRC 336 provides for gain or loss to be recognized by the liquidating corporation on the distribution of property as if the property were sold at its FMV.
- Built in Gains tax (Subchapter S Corporations) – When an S Corporation sells or distributes property in liquidation, the gain may be subject to a higher tax rate. Also, gains may be taxable to the shareholder.
- Bad Debt Reserve (Financials) – If an account is received by the corporation through the sale or other disposition of its A/R, in excess of their "net tax basis", such income is taxable in the last year that the corporation is subject to tax.
- Net Operating Loss – Corporation's frequently claim 100% of losses when only 50% are allowable. They also forget previously ineligible NOLs expire before the normal 5 years, and new ESB guidelines only apply to corporations with losses after 01/01/94.

6. Completed Folders - Corporation folders that were reviewed and surveyed - * * * * *

7. Audit to be opened or Field Referral –

- * * * * *
- * * * * *
- Create a PASS case. The issue folder should address that the case was assigned from a tax clearance box and the Box Number needs to be identified.

8. Take the completed box to reviewer for their final review.

9. Initial audit contact letter

- Prepare initial contact letter and include a paragraph, "A Tax Clearance Certificate cannot be issued until this examination is completed."
- * * * * *

10. Audit review completed – NPA is issued

- Prepare workpapers as usual. Prepare the NPA and include a paragraph stating, "A Tax Clearance Certificate cannot be issued until this notice has gone final."
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NOTE: ((* *)) = Indicates confidential and/or proprietary information that has been deleted.

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15010 POST DISSOLUTION GENERAL

Qualified corporations must formally dissolve or withdraw through the Secretary of State. To do this all returns must be filed and taxes paid.

After a corporation has formally dissolved through the Office of the Secretary of State, a magnetic tape is sent from the Secretary of State reporting all the newly dissolve corporations. FTB runs this tape periodically against BETS and updates the corporation's status * * * * *. A quarterly BETS report (Dissolved Corp List) is generated that reports all newly dissolved corporations. This list is used by the lead auditor to request the work from DSS.

Data Services personnel also use this list to pull the folders of dissolved or withdrawn corporations from the active files. They process the folders by stamping the date of dissolution in the "PD Audit" box on the face of the folder. The folders are routed to Audit at the request of the post-dissolution lead auditor approximately nine to 12 months after dissolution or withdrawal.

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15020 AUDIT CONTROL OF DISSOLVED CORPORATIONS

When the folders of dissolved corporations are received, the auditor/tax technician assumes full responsibility for control of the folder by entering their initials in the "PD Audit" box of the folder. Upon completion of the audit, the auditor/tax technician initials and dates (mm/yy) the top of the "PD Audit" box. Any folder received by Data Services with an open "PD Audit" box will be forwarded to the Post-Dissolution Unit for appropriate action.

15030 RELATED FOLDERS MISSING

Before any audit action is taken, folders for all related corporations that are dissolved should be requested so that the entire file can be audited at the same time. If the tax clearance worksheet indicates multiple clearances were issued, check the following sources for the names of the related corporations:

- Correspondence attached to the tax clearance
- Assumption of Liability
- Dissolving corporation returns
- The PASS System

15040 PROCESSING FOLDERS

The contents of the folder should be arranged in proper order to identify any missing items.

The Tax Clearance correspondence and loose paperwork should be arranged in chronological order and stapled together with the Tax Clearance Certificate on top. The Tax Clearance package should be placed in front of the folder. The determination made ("Reorganization"/"No Reorganization") must always be shown on the upper right corner of the tax clearance certificate.

15050 LATEST RETURN NOT IN FOLDER

Review the account to determine if all returns have been filed.

If the latest return is not in the folder:

- (1) The folder may be retained by the auditor and form FTB 6237 (Request for Corporation Folders) used to request the missing return, or
- (2) Send the folder back to Data Services to wait for the return to be filed.

If the latter method is used, control of the case is maintained by using the tickler control (Form FTB 6216). In order for Data Services to process tickler follow-ups (Form FTB 6216) efficiently, the following procedures have been established:

- 1) Check the "Pull Folder" box and mark "PD" by the "Pull Folder" box.
- 2) When writing the tickler pull date, use dashes (- -) instead of slashes (/).
- 3) Enter the corporation's name and number.
- 4) In the open year's field, list all of the open years needed to complete the audit. Circle, in red, the years that are missing.
- 5) Enter 68/(your initials)
- 6) Enter the current date.

Obtain a magenta flag (* * * * *), and:

- 1) Staple the magenta flag to the inside of the back cover of the corporate folder.
- 2) On the magenta flag, list the years of the missing returns.
- 3) Write the corporate number on the magenta flag.
- 4) If the missing year is the final return, enter the Document Locator Number (DLN) next to the missing year on the flag.

If the corporation account discloses that the required return has not been filed:

- 1) Review the tax clearance correspondence. If the Tax Clearance unit has requested a "balance due" payment, the corporation has made the payment, and there is a credit on the account, do not request a final return. Issue a supplemental assessment for the amount of the credit.
- 2) If that situation does not apply, (1) initiate a request for the return or (2) establish a tickler control if it appears that the return will be filed within the normal due date or the extended due date. If the missing return has not been posted within 90 days after the normal or extended due date, initiate a request for the return.

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15060 RETURNS IN FIELD

Contact the Field Office Audit Supervisor to determine if a field auditor or the Post Dissolution Unit should conduct the audit. If the audit is to be conducted by the field auditor, send the returns to the field using form FTB 7024 (Request for Field Action). * * * * *

* * * Special instructions may be given, if needed.

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15070 REQUESTING CORPORATE FOLDERS

Requests should be made in accordance with the following procedure:

Rush cases	Folders may be requested by telephone if needed for telephone replies or other priority cases.
Special cases	Requests should be made on form FTB 6237 (Request for Corporation Folder) marked "Rush" in red. If Data Services cannot locate the requested folder in files, the requestor will be notified immediately and if further search is required, the requestor will request an outsearch. If more than one corporate folder is needed, a separate form FTB 6237 should be prepared for each corporation and the forms staggered for easy identification.
Routine cases	Requests should be made on form FTB 6237. The requested corporations should be listed numerically. If the Data Services cannot locate the folders in file, the request will be returned to the requestor showing out information. If after two requests Data Services is still unable to locate the file the requestor may request an "outsearch." To request an outsearch you must call the Data Services and give them all the pertinent information. If Data Services is unable to locate the folders by the search date, they will return the request to the requestor as UTL (Unable to Locate). If the folder is still needed, another search date should be provided. If Data Services is unable to locate the folders after the second outsearch, the request will be referred to the Corporation Search Supervisor only if it is imperative that the folders be located.
Dead by Merger	The transferee folder should be requested.

15080 DISSOLUTION OF A CREDIT UNION

The effective date of dissolution for credit unions is the date they file their "Election to Wind-up and Dissolve" (Reg. 23331).

Financial Code §15656 controls and takes priority over §23331 of the Revenue and Taxation Code. Therefore, a credit union should be considered dissolved at the time it files a certificate of election to dissolve. Nevertheless, the credit union still needs to file the final papers of dissolution with the Secretary of State like every other corporation in order to dissolve.

Normally, the credit union or its representative will request a tax clearance certificate or may file a final return indicating dissolution. The tax clearance action will be the same as that of other corporations. However, if an election has already been filed, only the liability that accrued prior to the filing of the election will be required in order to obtain a tax clearance. Even though an election may already have been filed, no action will be taken at this time to remove the taxpayer from our active files. This action will be taken when notification is received on the miscellaneous change list from the Office of the Secretary of State.

15090 REORGANIZATIONS

For taxable years beginning January 1, 1984, §23251 of the California Revenue and Taxation Code has been amended to conform to §368 of the Internal Revenue Code regarding reorganizations.

If all the related folders are at hand and a determination of reorganization cannot be made, complete the audit of all returns in the dead folder and send a letter requesting the information necessary to make a determination.

If problems are encountered while auditing the returns, (1) include these items in a request for additional information, or (2) send the returns to the field with instructions to audit the returns and to determine if a reorganization has occurred.

Since one prerequisite for reorganization is a continuation of the transferor's business, it can be assumed that an inactive corporation will not transfer its assets pursuant to reorganization.

For State purposes, a transfer of assets and liabilities to a corporation that has been granted an exemption from tax under the California Revenue and Taxation Code or the State or Federal Constitutions cannot be a reorganization.

15100 FILING REQUIREMENTS FOR A MERGER

For taxable years beginning January 1, 1984, §23253 of the California Revenue and Taxation Code has been amended to conform to Section 381(b) of the Internal Revenue Code.

Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of Section 368(a)(1), the taxable year of the distributor or transferor corporation shall end on the date of the distribution or transfer.

15110 PROCESSING FINAL RETURN

When the final return with form FTB 6028, Return file flag, is received with the appropriate folder, determine if the return has been properly assessed and whether to audit the return.

Review the final return by:

1. Review the balance sheet. If the balance sheet reports an ending balance, look at assets and liabilities. You may need to request a complete schedule of assets and liabilities distributed in liquidation to determine the disposition of assets that are likely to appreciate such as land, buildings, or investments. Remember to ask for the book value and the fair market value of these assets
2. Review accounts receivable. A cash basis taxpayer must report all ending accounts receivable balance into income in the year of dissolution. Therefore, if a corporation had accounts receivable from services completed prior to liquidation, it should be included in income on the corporation's final return. See **MAPM 15180**.
3. Review the final return for deferred income. Unreported income from an installment obligation must be included in income for the corporation's final year. See **MAPM 15170**

When the return has been audited, discard the form FTB 6028.

If there was a tickler control, route the file copy of form FTB 6216 to Data Services with instructions to destroy the tickler copy.

15120 DISSOLVED PARENT OR "KEY" CORPORATION

Whenever the parent or key corporation dissolves or withdraws from doing business in California, the post dissolution auditors will bring the cross referencing up to date as well as the audit. If the key corporation in California is dissolved or withdrawn, a letter should be written to the parent inquiring as to which California subsidiary is to be designated the key corporation.

Usually when the parent dissolves or withdraws from California, it is due to a reorganization; and, the auditor should find the new parent for cross-referencing purposes. However, if the dissolved or withdrawn parent previously made an election to file a single return and pay the tax for a unitary group, the auditor must write and ask the new parent to file an election form FTB 4523B, Authorization For Single Notices, if it wishes to continue to file in the same manner. See MAPM 7090

15130 COMPUTATION OF FINAL TAX (§23151.1)

California Revenue and Taxation Code §23153 states in part that “Every corporation is subject to the minimum franchise tax from the date of incorporation, qualification, or commencing to do business within this state, until the effective date of dissolution or withdrawal from the Office of the Secretary of State, or if later, the date the operation ceases to do business within the limits of this state”. The corporation must pay the minimum tax for every year or part year that they exist, whether or not they are actively conducting business.

Corporations must dissolve or withdraw and receive a final certificate of dissolution/withdrawal from the Office of the Secretary of State. The taxable year is terminated at the end of the month of dissolution or withdrawal, and a final return is due two and one-half months later. The tax on the final return is based on the tax measured by net income for the year of dissolution or withdrawal, plus the tax based on net income for the preceding taxable year (but cannot be less than the minimum tax). The tax rate in effect during the month of dissolution/withdrawal is used to measure the final tax.

For financial corporations tax for the year of dissolution is to be computed at the maximum financial rate unless the proper rate has been determined. The full amount of financial offset is allowable, except that the tax may not be less than the tax computed by the general rate or less than the minimum tax.

15140 FIRST YEAR TAX CREDIT

The first year tax credit is applicable only if a corporation commenced doing business in this state before January 1, 1972. The credit allowed is the excess of the tax paid over the minimum tax for the first taxable year that constitutes a full 12 months of doing business.

The first year tax credit is allowed against the final tax. Any excess first-year credit over the final tax is applied to any unpaid liability and the balance refunded to the taxpayer.

R&TC §23202 requires the first-year credit of a transferor in a reorganization to be deferred, and allowed to the transferee at the time it dissolves or withdraws. A corporation filing as an S Corporation is allowed one-third of the first-year credit R&TC §23803.

Any adjustment to the final return or account due to a first-year credit, year change, cancellation, or refund will be made by using form FTB 6213A, Accounting Instructions Corp.

Bank and Corporation Account purge files are located on Microfiche in clerical support section:

Recordax: Alpha – Tax years 1946 – 1968 (tax years in ledger cards 1– 45)

Memorex: 1974 purge – tax years 1968-1972 (1–47 and 1-11)

1977 purge – taxable years 1972-1973 and since 1974 (1-107)

The Record Center has ledger cards back to 1936. To request this information use form FTB 6221. These requests normally take two weeks.

15150 REFUNDS

The auditor may receive folders asking that a determination be made and the amount of tax or payments be refunded when the folder has not been stamped with the "PD Audit" box and date of dissolution. In those cases, where a tax clearance certificate has been issued, access the Office of the Secretary of State's records to find out if the corporation has dissolved. If it has been dissolved, indicate on the tax clearance certificate "Reorg." or "No Reorg." In addition, stamp the front of the folder with the "PD Audit" box. Enter the date of dissolution, your initials, and the date. In the "PD Audit" box, enter the date the audit was completed and your initials.

If the corporation has an overpayment and a claim number has been assigned and a determination has not or cannot be made, send a letter requesting the required information.

Using form FTB 6213A, Accounting Instructions Corp, will make any adjustment to the final return or account due to a first-year credit, year change, cancellation, refund, etc.

Generally, refunds will be based on first-year credit or credit balance from estimated payments.

15160 AUDIT ISSUES

Check ownership information on page 1 of the return, the percent of corporation stock owned on Schedule E, and Compensation of Officers on Schedule E. A review of the balance sheets on all available returns may indicate a change of ownership (i.e., fluctuation of investments in capital stock section).

If the final return indicates dissolution but there is a large net income and/or the balance sheet indicates a large amount of assets and there is no indication of the disposition, initiate an IDR for additional information.

For specific issues, see:

- Deferred installment sale income **MAPM 15170**
- Accounts Receivable **MAPM 15180**
- Gain on Distribution of assets **MAPM 15190**
- Subchapter S Corporations **MAPM 15200**
- Bad Debt Reserve **MAPM 15210**
- Net Operating Loss **MAPM 15220**

15170 DEFERRED INSTALLMENT SALE INCOME

If no reorganization occurred, §24672 of the California Revenue and Taxation Code requires a corporation to include in its measure of tax the unreported income from an installment obligation it holds at the time the corporation is no longer subject to the tax imposed by Chapter 2 or 3.

The installment note's basis is then increased to its face amount pursuant to the acceleration of §24672. In accordance with R&TC §24667 and IRC §453B, the corporation should recognize gain or loss on the difference between the fair market value of the note and its basis.

If a corporation has sold property on the installment basis in prior years, the deferred gain may not be shown on its ending balance sheet. Care must be taken to check prior year returns for installment sales. This item is particularly important if no reorganization occurred.

If the corporation merges with a California corporation, the income remains deferred. However, if the California corporation merges with an out of state corporation, CR&TC §24672 applies and we can accelerate the income.

15180 ACCOUNTS RECEIVABLE

Accounts receivable that were earned by a cash basis corporation, before the distribution in liquidation, are taxable under §24651(b) of the California Revenue and Taxation Code.

If a final return reports zero gross receipts, but the balance sheet reports accounts receivable on the beginning balance, a statutory NPA maybe issued. It may be necessary to write to the corporation and request the amount of account receivable not previously reported as income by the corporation, which were distributed to the shareholders.

15190 GAIN ON DISTRIBUTION OF ASSETS

§336 of the Internal Revenue Code provides for gain or loss to be recognized by the liquidating corporation on the distribution of property as if the property were sold at its fair market value.

If the corporation has assets remaining in the ending balance of the balance sheet or it cannot be determined if there is a gain or loss on the distribution of assets, it may be necessary to write to the corporation and request a schedule showing the gain or loss on the distribution of property in complete liquidation. The gain or loss is determined as if the property had been sold at its fair market value as of the date of distribution.

15200 SUBCHAPTER S CORPORATION

When an S Corporation sells or distributes property in liquidation, the gain may be subject to a higher tax rate as provided in §1374 of the Internal Revenue Code. The same rules apply to S Corporations as for C Corporations regarding the recognition of gain or loss on distribution of assets.

§453(h) of the Internal Revenue Code provides that, except for purposes of any tax imposed by subchapter S, no gain or loss is recognized by the distributing S Corporation with respect to the distribution of installment obligations. This section does not apply for California corporation purposes since California imposes not only IRC Section 1374 (tax on certain gains and built-in gains tax), but also on entity-level tax. Consult your lead before opening any issues on an S corporation.

15210 BAD DEBT RESERVE

If an amount is received by the corporation through the sale or other disposition of its account receivable, in excess of their "net tax basis," such income is taxable in the last year that the corporation is subject to tax. "Net tax basis" equals face value less the bad debt reserve.

When there is a reorganization or merger, bad debts need not be included in income.

15220 NET OPERATING LOSS

Corporations frequently claim 100% of losses when only 50% are allowable. They also forget that “previously ineligible” NOLs expire before the normal 5 years, and that the new “ESB” guidelines only apply to corporations with losses after 1/1/94. For more information on NOLs, see **MATM 8000**.

15230 DEFINITIONS

- Liquidation - Corporation disposes of its assets and liabilities. Incorporation and Dissolution - Formal action of domestic corporations through the Office of the Secretary of State.
- Qualification and Withdrawal - Formal action of foreign corporations through the Office of the Secretary of State.
- Transferor - A corporation that transfers its assets and liabilities to another corporation.
- Transferee - A corporation that receives the assets and liabilities of another corporation.
- Reorganization - A transaction in which a corporation combines or transfers assets and liabilities or stock and whose business is continued by another corporate entity or management.
- No Reorganization - A transaction in which a corporation distributes its assets and liabilities to stockholders and whose business is not continued by another corporate entity. The corporation is not considered a party to reorganization.